CALIFORNIA STATE DEPARTMENT OF EDUCATION
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MANAGEMENT ADVISORY NO. 92-04

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TO: County and District Superintendents
County and District Chief Financial Officers

FROM: Robert W. Agee
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SUBJECT: Criteria and Standards For Temporary Borrowing (Short-Term) Debt Issuance

This advisory contains criteria and standards for use by the State Superintendent of Public Instruction and county superintendents to review debt instruments proposed by local educational agencies (LEAs) having a qualified or negative certification in either the current or prior fiscal year. Although Education Code Section 42133 applies to both temporary (short-term) and long-term debt, due to pending legal issues this management advisory is limited to temporary borrowing which must be repaid in full out of revenues of the fiscal year in which the borrowing occurs. Examples are Tax Anticipation Notes (TANs), Revenue Anticipation Notes (RANs), and Grant Anticipation Notes (GANs). We will be issuing a separate advisory on long-term debt such as Certificates of Participation (COPs) at a later date. This management advisory is part of a series of advisories regarding the provisions of AB 1200 (Statutes of 1991, Chapter 1213); see Management Advisory 92-03 for details concerning the other major provisions of AB 1200.

The purpose of the criteria and standards is to establish statewide guidelines that will promote a uniform basis for approval or disapproval of debt instruments that do not require the approval of the voters of the district. The criteria and standards affect only those LEAs which have a qualified or negative certification during the current or prior fiscal year, therefore, the implementation of these standards will not affect LEAs which have positive certifications. Application of the criteria and standards should facilitate a productive dialogue between the issuing LEA and the approving agency prior to the LEA incurring the debt.

Education Code sections 42133 (a) and (b) read as follows: "(a) A school district that has a qualified or negative certification in any fiscal year may not issue, in that fiscal year or in the next succeeding fiscal year, certificates of participation, tax anticipation notes, revenue bonds, or any other debt instruments that do not require the approval of the voters of the district, nor may the district cause an information report regarding the debt instrument to be submitted pursuant to subdivision (e) of Section 149 of Title 26 of the United States Code unless the county superintendent of schools determines, pursuant to criteria established by the Superintendent of Public Instruction, that the district's repayment of that indebtedness is probable. A school district is deemed to have a qualified or negative certification for purposes of this subdivision if, pursuant to this article, it files that certification or the county superintendent of schools classifies the certification for that fiscal year to be qualified or negative.

(b) A county office of education that has a qualified or negative certification in any fiscal year may not issue, in that fiscal year or in the next succeeding fiscal year, certificates of participation, tax anticipation notes, revenue bonds, or any other debt instruments not requiring the approval of the voters of the district, nor may the county office of education cause an information report regarding the debt instrument to be submitted pursuant to subdivision (e) of Section 149 of Title 26 of the United States Code unless the Superintendent of Public Instruction determines that the repayment of the indebtedness by the county office of education is probable. A county office of education is deemed to have a qualified or negative certification for purposes of this subdivision if, pursuant to the article, it files that certification or the Superintendent of Public Instruction classifies the certification for that fiscal year to qualified or negative. For purposes of this subdivision, "county office of education" includes a school district that is governed by a county board of education."

Temporary Borrowing Debt Issuance

TANs, RANs, and GANs are short-term borrowing instruments used to finance cash flow deficits in anticipation of receiving taxes, other revenues, or grants. Generally, they are issued for 12 months or less and are repaid out of revenues of the fiscal year in which the borrowing occurs.

The keys to determining the probability of debt repayment are a cash flow analysis and an analysis of the LEA's fund balance. These processes should provide the reviewer with assurances that:

- the revenues pledged to repay the note will be received on or prior to the pledge date;
- the amount of the revenues pledged to repay the note are sufficient;
- the note will be repaid in full out of revenues of the fiscal year in which the borrowing occurred;
- the revenues used to repay the note are composed of funding sources which have a high degree of certainty of occurring and in the amount projected.

The cash flow analysis should provide the beginning balance, revenues, expenditures, and ending balance for each month of the fiscal year. The analysis should focus on the unrestricted portion of the General Fund budget as well as any restricted portion of the budget that will impact the unrestricted portion, and should include all the assumptions used. In addition, the LEA should provide the reviewer with trends and composition of revenues, trends and composition of the LEA's expenditures, factors driving those costs, impact of the borrowing, and projected monthly cash balance.

If the repayment provision does not in any way obligate the General Fund, the LEA should perform a similar analysis of the funds or revenues pledged to repay the note.

The Review of the LEA's Cash Flow Analysis

The reviewer should subject each of the LEA's assumptions and projections to a test of reasonableness. This will require the reviewer to examine each assumption and to compare it to what has happened historically and to what is presently occurring. It will also require that the reviewer be familiar with local developments, apportionment schedules, and economic trends at both the state and national level.

After reviewing the trends and composition of both the LEA's revenues and expenditures and the factors affecting them, the reviewer should carefully review the LEA's projected fund balance. If the LEA can meet all of its obligations including repayment of the note and yet maintain a sufficient fund balance then there is a reasonable probability that the LEA will repay its debt.

The two criteria that should be applied to temporary borrowing are: (1) Fund Balance and (2) Cash Flow Analysis. These criteria are the same as those that were adopted by the State Board of Education on July 13, 1990, as part of the criteria for interim financial reports pursuant to Education Code Section 33127.

CRITERIA AND STANDARDS FOR REVIEWING SCHOOL DISTRICT NON-VOTER APPROVED TEMPORARY BORROWING

Criteria	Standards
Cash Flow Analysis	Cash Flow analysis indicates that there will not be a negative cash balance at, or before the end of the fiscal year.
Fund Balance	Expenditures do not exceed revenues, and do not create a negative fund balance.
	Reserve for Economic Uncertainties is not less than the following percentages as applied to total expenditures, transfers out and uses:

the greater of 5% or $50,000	for districts with 0 - 300 ADA
the greater of 4% or $50,000	for districts with 301 - 1,000 ADA
3%	for districts with 1,001 - 30,000 ADA
2%	for districts with 30,001 - 400,000 ADA
1%	for districts with 400,001 and over ADA

Budgeted salaries and benefits, reserves, and/or unappropriated fund balance are sufficient to address pending salary and benefit negotiations.

CRITERIA AND STANDARDS FOR REVIEWING COUNTY OFFICE OF EDUCATION NON-VOTER APPROVED TEMPORARY BORROWING

Criteria	Standards
Cash Flow Analysis	Cash Flow Analysis indicates that there will not be a negative cash balance at, or before the end of the fiscal year.
Fund Balance	Expenditures do not exceed revenues, and do not create a negative fund balance.
	Reserve for Economic Uncertainties is not less than the following percentages as applied to total expenditures, transfers out and uses:

the greater of 5% or $50,000 for Class 8 counties
the greater of 4% or $50,000 for Class 7 counties
3% for Classes 4, 5, and 6 counties
2% for Classes 1, 2, and 3 counties

Budgeted salaries and benefits, reserves, and/or unappropriated fund balance are sufficient to address pending salary and benefit negotiations.

Should you have any questions relating to the criteria and standards, please contact LeRoy Munsch in the Office of School Business Practices at (916) 322-1471.

NOTICE

To the extent that this Management Advisory contains guidelines in addition to recitation of the law, the guidelines are exemplary only and compliance with them is not mandatory.